

COUNTY OF SANTA BARBARA
DEBT CAPACITY REVIEW

Report to the
Board of Supervisors
April 13, 1993

Prepared By
LEIFER CAPITAL

OUTLINE

Purpose of a Debt Capacity Review

Summary of County Debt Profile (economic, financial, and debt indicators)

Findings and Recommendations

DEBT CAPACITY REVIEW

Importance

- **The County's ability to issue debt is a limited resource which must be managed**

Purposes

- **Integrate capital planning and financial management**
- **Understand and strengthen the County's market position**

Methodology

- **Examine the County's "Debt Burden" in context of current fiscal health and future financing needs**

Ultimate Benefit

- **Give County decision makers the information they need to ensure that the County has the capacity to borrow whenever necessary, under the most favorable terms afforded by the market**

ECONOMIC INDICATORS

Underlying economy is the key to the County's revenue base
















Ability to repay debt depends on resources the County can tap

- **Property tax, sales tax, State aid, etc.**



Indicators

- **Population growth (if growing, revenues should follow)**
- **Personal wealth (wealth of population determines revenue-raising ability)**
- **Employment (unemployed contribute less in taxes; require more services)**
- **Assessed Value (source of property tax and indicator of economic health)**

ECONOMIC INDICATORS: FINDINGS

Debt Capacity Indicator	Major Qualifying Factors
 POPULATION	 Slow Population Growth Rate  Cities Have an Increasing Share of County Population  Projected Increase in Dependent Population
 PERSONAL WEALTH	 High Per Capita Income Relative to State  Relatively Low Percentage of Families Below Poverty Level
 EMPLOYMENT	 Low Unemployment Rate Relative to State  Low Dependence on Specific Companies  Low Dependence on Specific Industries  Labor Force Growth Outpacing Job Creation
 ASSESSED VALUE	 Real Increases in Assessed Value  Declining Value of New Construction

KEY

-  Green (or dark) indicates that we view our findings as positive with regard to the County maintaining its current credit-worthiness, even with additional debt.
-  Yellow (or light) indicates that we view our findings as cautionary with regard to taking on additional debt. To maintain or receive an investment-grade rating, additional information or mitigating factors would be required.

FINANCIAL INDICATORS












Financial performance acts as an indicator of ability to support current and additional debt

Study focuses on General Fund because it is the ultimate source of debt service for most obligations



Indicators

- **General Fund revenues**
- **General Fund expenditures**
- **General Fund fund balance**

FINANCIAL INDICATORS: FINDINGS

Debt Capacity Indicator	Major Qualifying Factors
 REVENUES	 General Fund Expenditures Exceeding Revenues  State Budget Uncertainty  Increasing Dependence on State and Federal Aid  Growing General Fund Revenues
 GENERAL FUND EXPENDITURES	 Expenditure Growth Exceeding Revenue Growth  Increasing Public Assistance Expenditures
 GENERAL FUND FUND BALANCES	 Fund Balance at 5 Percent of Revenues  Significant Draw-down in Recent Years  Gann Limit Will Allow Revenue Increases

KEY

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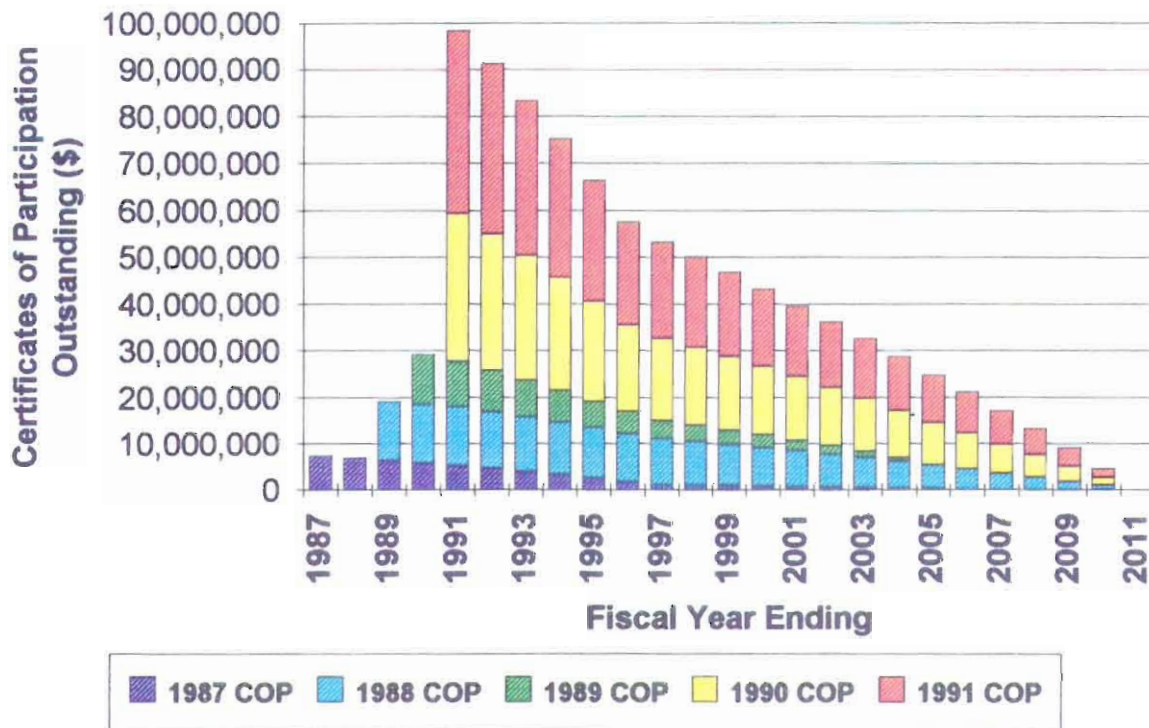
DEBT INDICATORS

Debt Ratios create a basic "credit profile" and allow comparisons to industry benchmarks

Indicator Ratios

- **Direct Debt to Population**
- **Direct Debt to Assessed Value**
- **Debt Service as a Percentage of General Fund Expenditures**
- **Overlapping Debt**

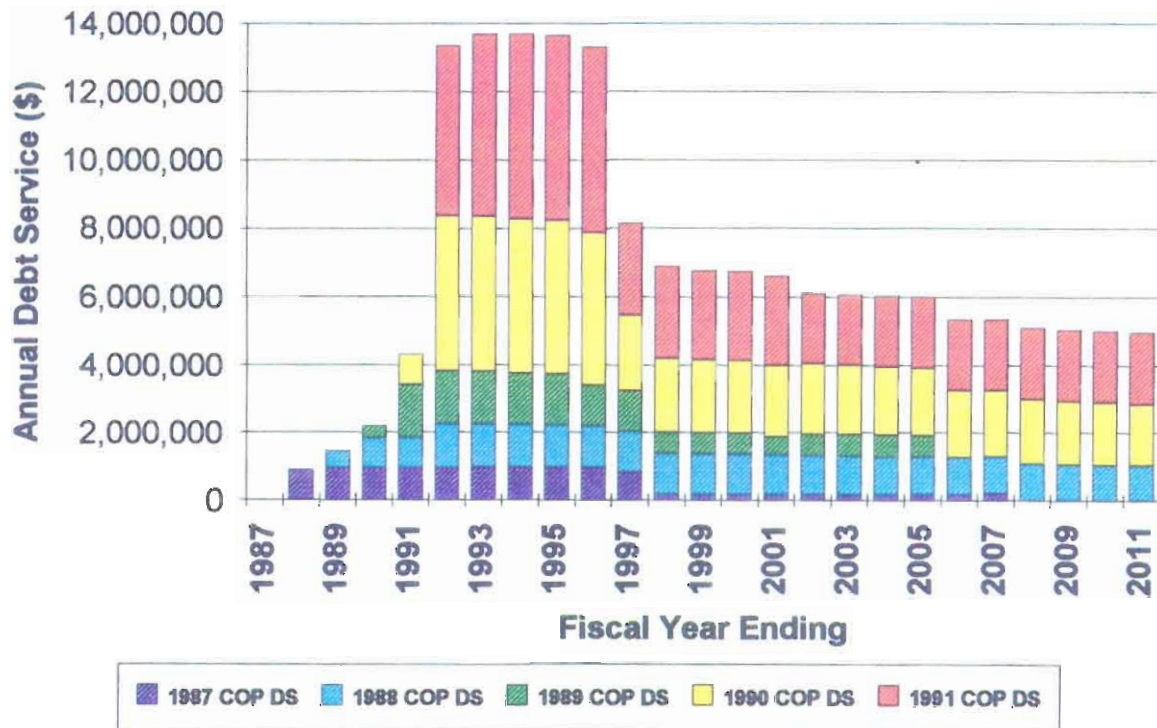
OUTSTANDING DEBT OBLIGATIONS



COPs have funded a wide variety of County projects

- 1987 COP:** Telephone equipment
San Antonio Building renovation
- 1988 COP:** Social Services Building
- 1989 COP:** County fire equipment and facilities
HVAC energy project
Court automation systems
- 1990 COP:** Betteravia Government Center
Montecito FD equipment and facilities
- 1991 COP:** Open space buffers
Santa Maria court facilities
Master lease pool
Computer equipment refinancing
Solid waste facilities

ANNUAL DEBT SERVICE PAYMENTS



A significant portion of the County's COP obligations are serviced by other sources in addition to the General Fund

1988 COP: State Department of Social Services

1989 COP: County Fire Protection District fees and taxes
Court automation fees

1990 COP: State Department of Social Services
Trial court funding
Montecito Fire Protection District

1991 COP: Courthouse construction funds
Refuse collection fees
RDA tax increment

DEBT INDICATORS: FINDINGS

Santa Barbara County is Within Rating Agency Benchmarks

RATIO	1990-91 Level	1991-92 Level	1992-93 Level	Agency Benchmark
Direct Debt to Population	\$270	\$250	\$224	\$256
Direct Debt to Assessed Value	0.51%	0.44%	0.39%	0.70%
Debt Service to General Fund Expenditures	1.8%	5.1%	5.2%	10.0%
Debt Service to General Fund Expenditures (less Public Assistance)	2.4%	6.9%	7.1%	10.0%
Net Direct and Overlapping Debt to Population	\$550	\$560	NA	\$997-\$1,200
Net Direct and Overlapping Debt to Assessed Value	1.03%	0.98%	NA	2.50%

Major Findings

- Revenue levels are sufficient to meet existing debt-service requirements; but only modest capacity exists for the County to issue additional debt.
- The County's credit profile includes some indicators and trends that credit agencies and other market participants may view with caution.

RECOMMENDATIONS

for

Integrating Capital Planning and Financial Management

- Further enhance the cost-effectiveness of County financing programs by continuing the ongoing practice of "Dynamic Debt Management".
- Require rigorous revenue source analysis and utilize debt capacity guidelines as part of the capital project decision-making process.
- Continue to forecast long-term revenues and expenditures, and use these forecasts to examine how decreases in revenue or increases in future debt service might "crowd out" the County's ability to pay for future operating expenditures.
- Review the *indirect* and *non-credit* implications of higher debt levels to determine how policy goals will be affected by the County's financing plans.

RECOMMENDATIONS

for

Strengthening the County's Market Position

- **Examine the actions the County can take to improve or maintain its marginal credit indicators.**
- **Highlight the administrative and policy strengths which set Santa Barbara apart from less pro-active municipal issuers.**
- **Communicate the County's credit-related initiatives by delivering a series of presentations to rating agencies, bond insurers and institutional investors.**
- **Explore the availability and cost-effectiveness of credit enhancement for refunding or new debt issuances.**
- **When considering a refinancing or a new debt issuance, continue the practice of applying for an "indicator" or "private" rating whenever the potential credit impact of the financing is uncertain.**

SUMMARY

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The Debt Capacity Review (DCR) examines Santa Barbara County's debt burden in light of the County's current fiscal health and future debt financing needs. It identifies the parameters for conserving the County's credit-worthiness by examining a range of indicators which, when taken together, serve as guideposts for determining the amount of debt¹ that can be safely and cost-effectively incurred.

There are two principal ways the County can use the findings from the Debt Capacity Review:

As a tool for planning County-wide capital project financing. The DCR provides information which will enhance County decision making and serve as a foundation for on-going review of key financial indicators.

As a tool for maintaining and enhancing the County's market position. The DCR aids County officials in recognizing credit strengths and weaknesses by analyzing factors which are of concern to rating agencies and investors.

GENERAL FINDINGS

Taken in sum, the results of our analysis indicate that the County's underlying credit-worthiness is still generally favorable. The County's A+ rating on outstanding COP issues places it well inside the "investment grade" credit range. However, numerous factors lead us to view with caution any additional debt issuance.

Although the County's economic profile is sound and all of its debt ratio indicators are positive, rating analysts and other market participants may be concerned about the trends in its financial indicators. These trends include: the four-year pattern of General Fund deficits, the downward trend in General Fund fund balance and the shrinking share of property tax revenue allocations. (For reference, the economic, financial and debt burden indicators which we have identified as cautionary are those colored yellow/light in Table 1.)

It appears that the County has been coping with the current recession by using its fund balances to maintain the existing level of services. In light of the State's ongoing budget crisis, and the resulting reduction in property tax revenues for local governments, rating analysts will expect to see the County make significant structural changes, rather than trying to balance the budget with one-time funds. The major factors in the County's favor are its relatively low unemployment and high personal income levels, as well as below average direct and overlapping debt ratios.

For its own planning purposes and to prepare itself for future rating agency discussions, the County should examine its current financial situation and determine how it will seek to adapt to future revenue reductions. The high level of County annual debt service payments over the next few years, coupled with uncertainty over future State actions, creates a generally unfavorable environment for issuance of additional debt in the near future. Before issuing any new debt, the

¹ Although California law distinguishes between "debt" and other forms of long-term obligations such as leases, we will generally use the term "debt" to apply to all types of long-term obligations.

County should specifically identify additional revenue sources for debt service that do not affect the General Fund, or identify off-setting cost savings to the General Fund that are a direct result of the proposed capital improvement.

Following this summary, the report begins in Section I with a discussion of the purposes of a DCR and the indicators we use to analyze the County's credit position. Sections II, III, and IV examine, respectively, the County's economic, financial, and debt burden indicators. Section V summarizes our findings and presents sensitivity analyses which can assist the County in evaluating the potential impacts of future debt burden scenarios. Section VI concludes the report with nine recommendations for maintaining and improving the County's capital project financing programs and the County's market position.

KEY INDICATORS

In general, we gauge the capacity of a county to incur debt by the amount, sources, and quality of its revenue, and by its practical and legal ability to draw upon these sources. Our approach is to examine the principal characteristics of the County, which, when considered together, become key indicators of the County's credit-worthiness.

Our analysis follows the major categories established by the rating agencies: the County's economic condition, financial condition, and debt burden. We summarize Santa Barbara County's credit profile as reflected by the key indicators and the major "qualifying factors" for each indicator in Table 1. We colored-coded each indicator and qualifying factor to designate whether it would positively or negatively influence Santa Barbara's capacity to maintain its current credit rating and take on additional debt. *Although we view some of our findings as cautionary with regard to taking on additional debt, we do not believe any of the County's indicators would preclude the County from achieving an investment grade rating on future financings.*

Economic Indicators

The ability of a local government to pay for its debt is conditioned, in large measure, by the community's revenue base; one major bond rating agency considers the underlying economy the single most important consideration when evaluating the credit-worthiness of a local public agency. Factors such as population, personal wealth, economic diversity, growth rates of employment, property values, and other trends help to determine the ability of the issuer to support current and future debt levels.

Population growth is slower than the statewide average. During the 1980's Santa Barbara County was one of the slower growing counties in California, growing almost 13% slower than California's counties as a group. Rating analysts would view Santa Barbara's slow population growth as neither a positive nor a negative indicator of the health of the County's economy. However, two underlying trends in the population may exacerbate the revenue-raising implications of the slow increase in population.

First, we found that, because of annexations and incorporations, the incorporated areas account for an increasingly larger percentage of the County's population. When County unincorporated land becomes part of a city, the County loses the 1% local jurisdiction tax revenues raised from retail

ECONOMIC INDICATORS

FINANCIAL INDICATORS

DEBT INDICATORS

	POPULATION <ul style="list-style-type: none"> Slow Population Growth Rate Cities have an Increasing Share of County Population Projected Increase in Dependent Population 		REVENUES <ul style="list-style-type: none"> General Fund Expenditures Exceeding Revenues State Budget Uncertainty Increasing Dependence on State and Federal Aid Growing General Fund Revenues 		DIRECT DEBT <ul style="list-style-type: none"> Low Direct Debt Per Assessed Value Low to Moderate Direct Debt Per Capita
	PERSONAL WEALTH <ul style="list-style-type: none"> High Per Capita Income Relative to State Low Percentage of Families Below Poverty Level 		GENERAL FUND EXPENDITURES <ul style="list-style-type: none"> Expenditure Growth Exceeding Revenue Growth Increasing Public Assistance Expenditures 		OVERLAPPING DEBT <ul style="list-style-type: none"> Low Overlapping Debt Per Assessed Value Low Overlapping Debt Per Capita
	EMPLOYMENT <ul style="list-style-type: none"> Low Unemployment Rate Relative to State Low Dependence on Specific Companies Low Dependence on Specific Industries Labor Force Growth Outpacing Job Creation 		GENERAL FUND BALANCES <ul style="list-style-type: none"> Fund Balance at 5 Percent of Revenues Significant Draw-down in Recent Years Gann Limit Will Allow Revenue Increases 		DEBT SERVICE LEVEL <ul style="list-style-type: none"> Low Debt Service to Expenditure Ratio Debt Service from Other Than Gen. Fund
	ASSESSED VALUE <ul style="list-style-type: none"> Real Increases in Assessed Value Declining Value of New Construction 		KEY <p>We view our findings as positive with regard to the County maintaining its current credit worthiness, even with additional debt.</p> <p>We view our findings as cautionary with regard to taking on additional debt. To maintain or receive an investment-grade rating, additional or mitigating factors would be required.</p>		

Table 1

sales on the land, transient occupancy tax revenues and, a part of the property tax revenues. Although there is also a reduction in service responsibilities to the area which mitigates part of the reduced County revenues, the resulting cost savings typically does not make up for the lost revenue. Second, a projected increase in the percentage of senior citizens may put greater demands on the County for reduced taxes and increased services after the year 2000.

Personal wealth is above average. Even though the population is slowly growing, it is the wealth of the population that directly determines Santa Barbara County's ability to raise revenues, minimize public assistance expenditures, and ultimately pay its debts. Santa Barbara County's per capita income in 1990 was \$21,504, which is viewed by rating agencies as high relative to the California state-wide level of \$19,840. During the 1980s, Santa Barbara's per capita income grew by more than 2.5 times and the gap between Santa Barbara and state income widened.

Even though Santa Barbara residents have relatively high income, the rating agencies place great emphasis on the County's demonstrated ability to successfully meet its obligations. It is more important that the County has a strong track record of servicing its debt, and a budget which accurately reflects its anticipated revenues.

The unemployment rate is below the statewide average. Consistent with state-wide trends, Santa Barbara County's unemployment rate has grown, rising from 4.4% in 1988 to 6.7% in 1992. However, for the past five years these rates have been consistently below the statewide average by one to two percentage points. Discussions with both Standard & Poor's and Moody's confirmed that Santa Barbara's unemployment rate is low relative to other California counties and as such, would be viewed positively.

There is, however, some concern locally that the greatest impact of the recession is still to be felt by Santa Barbara County and that unemployment rates may go higher. During a national recession, high unemployment would generally be of greatest concern to rating analysts if it deviates significantly from its historical relation to the state unemployment rate. Two factors however, would somewhat mitigate any short-term concern over future unemployment rates. First, Santa Barbara is not overly dependent upon any specific firm for employment. Second, Santa Barbara's workforce is relying increasingly on the expanding non-public service sector.

Real assessed value is growing. In real terms, County assessed value increased at a 3.1% rate from 1988 to 1992. This rate indicates a growing residential and commercial property tax base that rating agencies would consider healthy and a positive indicator of credit-worthiness. We note however, that this rate is less than the statewide annual real growth rate of 5.5%. The County's relatively slow rate of growth is probably the result of city and County growth policies.

Financial Indicators

When considering credit-worthiness, rating agencies and investors consider the issuer's overall financial condition including revenues and expenditures, annual surpluses or deficits, and changes in fund balances.

General Fund revenues have increased but the future is uncertain. From FY 1987-88 to FY 1991-92 General Fund revenue increased by 7.1% on an annual compound basis, from \$191.8 million to \$269.8 million. Per capita General Fund revenues increased from \$556 to \$697 during the same period. Despite this five-year trend of increasing revenue growth, an expected decline in the percentage of total property taxes received by the County General Fund could cause concern among rating agency analysts. This decline is expected for two primary reasons.

First, in FY 1992-93 the State's tax-shift solution to its budget crisis reduced the County's share of property tax revenues by over \$5 million. If the Governor's proposed budget is adopted, it is expected to reduce the County's property tax revenues by a total of almost \$10 million in FY 1993-94.

Second, incorporation and annexation activity has increased. When incorporations occur, the County must forgo a portion of the property tax it had received from the incorporating area. This allocation is based partly on the cost of services which the County formerly provided to the newly incorporated area. For example, the city of Buellton incorporated in 1992, resulting in a loss of property tax to the County of \$158,600 in FY 1992-93.² The reduction in property tax and sales tax revenues from an annexation or incorporation is usually not fully mitigated by the accompanying reduction in service costs.

General Fund expenditures have grown more rapidly than revenues. From FY 1987-88 through FY 1992-93 General Fund expenditures increased by 9.2% on an annual compound basis, rising from \$188.3 million to \$292.5 million. Per capita expenditures increased from \$546 to \$755 during the same period. Rating agencies and investors would generally look upon these General Fund expenditure trends with concern, because on an annual compound basis General Fund expenditures increased at a faster rate (at 9.2%) than revenues (at 7.1%).

As the State and the federal government explore expenditure reduction alternatives, rating agencies will monitor the County's ability to adjust service levels to reflect any decreases in funding. As long as expenditures on mandated programs appropriately reflect the corresponding aid revenues received, the *relative* rather than *absolute* levels of revenues and expenditures will be the key indicator of the County's discretionary spending capability. Any future State actions which reduce discretionary revenues, however, such as the property tax shift in FY 1992-93, will clearly have a negative impact on the County's discretionary spending.

General Fund fund balances have remained at or above 5% of revenues. In FYs 1989-90, 90-91 and 91-92 expenditures exceeded revenues by \$4.0 million, \$13.7 million and \$6.1 million respectively. In FY 1992-93 the reduction in fund balance is expected to be \$11.5 million. Four years of spending more than it receives will reduce the County's General Fund fund balance from \$41.9 million at end of FY 1988-89 to \$13.5 million at the end of FY 1992-93.

According to Moody's, a fund balance of 5% of revenues is generally deemed prudent. The County General Fund fund balance is expected to drop to just 5% of revenues by the end of FY 1992-93. Because the County's General Fund balance provides a cushion for debt service payments, a decline in the fund balance indicates diminished capacity to assume new

²County of Santa Barbara, Office of the Auditor-Controller.

indebtedness. On the positive side, the County has substantial capacity remaining under its Gann Limit if it is necessary to raise additional revenues.

Debt Burden Indicators

Common indicators of debt burden include ratios such as debt per capita, debt-to-assessed valuation, and annual debt service as a percentage of annual expenditures.

By the end of FY 1991-92 direct debt had increased to over \$91 million. The County's COP obligations expanded from approximately \$7.4 million in FY 1986-87 to \$91.3 million in FY 1991-92, more than tripling in FY 1990-91 alone. As principal is amortized under current payment schedules, direct debt will fall by a compound annual rate of approximately 11% until 1996, and then decrease by an approximate annual rate of 9% until the final maturity of the 1991 COP in 2011.

All of Santa Barbara's COPs are fixed-rate issues, and all but the 1988 COP have front-weighted amortization schedules. Although rating analysts and investors will consider the General Fund as the ultimate source of debt service for credit purposes, it is important to understand that a significant portion of the County's annual COP obligation is currently serviced through other sources. Important sources include the State Department of Social Services matching funds for the County's social services building, refuse collection fees for solid waste facilities and the related Baron Ranch open space buffer, SB 688 courthouse construction funds for the Santa Maria courts facility, a redevelopment agency tax increment for the Isla Vista open space buffer and Fire Department fees and taxes to support fire station facilities and equipment. The perceived stability of these other sources determines to what extent they may be considered by analysts in determining the strength of the County's credit.

Debt Ratios are Favorable. Table 2 summarizes Santa Barbara County's key debt burden ratios and their relationship to current rating agency medians. Santa Barbara's debt service ratios are currently below the rating agency benchmark levels.

This has not always been the case. In FY 1990-91 the issuance of the County's two most recent COPs pushed the County's ratio of direct debt per capita to \$270, or 5% above the rating agency median of \$256 for comparable-size counties. Principal payments brought the ratio back down to \$250 in FY 1991-92 and an estimated \$224 by 1992-93. We note that even with a higher than average debt per capita in FY 1990-91, the County still maintained its A+ rating.

The County's direct debt has remained well below the rating agency median of 0.7% of assessed value -- reaching only 0.51% at its highest point in FY 1990-91. At the FY 1991-92 level of 0.44% of assessed value, the differential between the County's level and the rating agency median would represent the potential of a \$55.5 million "cushion" for additional direct debt if debt capacity were judged solely against this indicator. In FY 1992-93 the level is expected to fall to 0.39%.

The County's debt service is well below the 10% of General Fund expenditures benchmark at which rating agencies may become concerned. Even when measured against a "deflated" standard

Santa Barbara County is Within Rating Agency Benchmarks

RATIO	1990-91 Level	1991-92 Level	1992-93 Level	Agency Benchmark
Direct Debt to Population	\$270	\$250	\$224	\$256
Direct Debt to Assessed Value	0.51%	0.44%	0.39%	0.70%
Debt Service to General Fund Expenditures	1.8%	5.1%	5.2%	10.0%
Debt Service to GF Expenditure (less Public Assist.)	2.4%	6.9%	7.1%	10.0%
Total Direct and Overlapping Debt to Population	\$550	\$560	NA	\$997-\$1,200
Total Direct and Overlapping Debt to Assessed Value	1.03%	0.98%	NA	2.50%

Table 2

of General Fund discretionary expenditures (General Fund expenditures less public assistance expenditures), debt service still remains significantly below the 10% level of concern.

We note however, that debt ratios below the rating agency benchmarks and the ability to pay for debt are not necessarily the same thing. Even though per capita debt and debt to assessed value ratios are below the benchmarks, the annual burden of paying for outstanding debt has not eased. Over the past three years, debt service has become an increasingly larger component of General Fund expenditures.

SENSITIVITY ANALYSIS

We performed sensitivity analyses to estimate the range of possible debt capacity under varying assumptions. We summarize our assumptions and the results of our analyses in Table 3.

This table exhibits somewhat different estimates of additional debt capacity. The first two indicators examine the total outstanding debt that can be supported. The lower estimate of \$22 to \$24 million is derived by using the per capita benchmark median of \$256. The upper estimate of \$83 to \$91 million is derived by using the assessed value benchmark median of 0.7% of net assessed value. As previously discussed, the drawback to relying on a capacity estimate based on any particular assessed value scenario is the vulnerability of the County to reallocation of property tax revenues. By shifting property tax revenues away from the County, the State effectively negates some of the revenue growth resulting from increases in assessed value.

The third indicator examines the annual supportable debt service. Table 3 provides an estimate of about \$6 million in additional debt service capacity for 1994.

All of these estimates presuppose that rating agencies will assume that the General Fund is the sole source of debt service. The County's actual ratio-based capacity, if other funds are considered, could be higher, depending on the extent to which rating agencies or investors choose to rely on the other sources of debt service payments.

Agency Benchmarks Indicate Additional Debt Capacity

Benchmark Ratio	Annual Growth Rate Assumptions	Agency Benchmark	Additional Capacity in FY 1994
<u>Total Debt</u>			
Direct Debt to Population	<i>Population:</i> 1.1-2.1% 1993-00	\$256	\$22-\$24 million
Direct Debt to Net Assessed Value	<i>Assessed Value:</i> 2.0-7.0% 1993-00	0.7%	\$83-\$91 million
<u>Annual Debt Service</u>			
Debt Service to General Fund Expenditures	<i>Assessed Value:</i> 4.5% 1993-2013	10%	\$6-\$7.5 million (annual debt service)
	<i>GF Expenditures:</i> 4.5% 1993-2013		

Table 3

Although the ratios appear to indicate that the County currently has some capacity for new debt, we reiterate that using this capacity may lead to lower-than-current rating levels within the investment-grade categories. In addition, it is important to recall that ratios play only a partial role in the actual credit evaluation process. Qualitative factors such as the regional economy or anticipated state budget cuts are also important. The bottom line is that the County's ability to demonstrate a long-range financial plan, which realistically and thoughtfully addresses both the County's needs and its capabilities, will determine how its credit is viewed in the bond market. A critical part of that plan is the determination of financing goals and constraints, and below and in the concluding section of this DCR, we recommend several means by which the County can develop guidelines to make those determinations.

RECOMMENDATIONS

The following recommendations are aimed at both enhancing the County's planning for capital project financings and improving its position in the capital markets. They will build on the strong management practices already established in Santa Barbara, and will assist in linking the findings of the DCR to the County's existing operating and capital budgeting process.

Recommendation 1: Further enhance the cost-effectiveness of County financing programs by continuing an ongoing practice of "dynamic debt management". This requires a constant commitment to integrate short-term and long-term financing goals, monitor current debt-funded projects, compile up-to-date financial and credit information, regularly review outstanding obligations for refunding or restructuring opportunities, continually adjust reinvestment strategies, and update debt management policies.

Recommendation 2: Require a rigorous revenue source analysis and utilize debt capacity guidelines as part of the capital project decision-making process. Central to the debt capacity guidelines should be the requirement for any potential project to have a well-defined revenue source which will prevent or minimize additional impact on the General Fund. Revenue sources could take many forms, including: operating savings generated by the project; user fees and enterprise revenues; intergovernmental reimbursements; benefit assessments; sales tax revenue increments; and general obligation bond tax increases.

Recommendation 3: Continue to forecast long-term revenues and expenditures, and use these forecasts to examine how decreases in revenue or increases in future debt service might "crowd out" the County's ability to pay for future operating expenditures. To obtain an accurate measure of debt capacity, the County must also consider the future relationship between the cost of providing public services and its ability to generate revenues sufficient to "cover" those costs.

Recommendation 4: Review the indirect and non-credit implications of future debt levels to determine how policy goals will be affected by the County's financing plans. This would include the equity implications of the manner in which payments for proposed projects are divided between current and future taxpayers, the tax incidence of the revenue schemes which have been proposed to support debt service, and whether the revenue source chosen to cover debt service will induce shrinkage in the tax base.

Recommendation 5: Examine the actions the County can take to improve or maintain its marginal indicators. Some of the yellow-flagged indicators are within the County's control, and could be improved by reducing costs, developing new revenue sources or implementing increases in current revenue sources.

Recommendation 6: Highlight the administrative and policy strengths which set Santa Barbara County apart from less pro-active municipal issuers. Even though the administrative and political issues that rating agencies might evaluate were not a requested part of this study, the importance of these factors to the credit standing and market image of the County should not be overlooked. Since the rating agencies and other market participants are influenced by these qualitative factors, it is useful for the County to review these factors so that it can highlight its managerial strengths and innovations when interacting with the credit agencies.

Recommendation 7: Communicate the County's credit-related initiatives by delivering a series of presentations to rating agencies, bond insurers and institutional investors. The County can best communicate its credit-strengthening activities through periodic on-site presentations. Unlike a credit presentation associated with a particular issuance, a periodic overview and update presentation allows the County to focus on the fundamentals of its credit situation rather than the specifics of the subject financing.

Recommendation 8: Explore the availability and cost-effectiveness of credit enhancement for refunding or new debt issuances. The most commonly used methods of credit enhancement are bond insurance and letters of credit (LOC). Depending upon market conditions, these mechanisms can reduce the cost of borrowing and increase the market for the County's debt issues.

Recommendation 9: Continue the practice of applying for an "indicator" or "private" rating whenever the potential credit impact of a refunding or new debt issue is uncertain. The indicator rating can protect the County's credit standing by allowing it to withdraw an issue that might negatively impact the ratings on outstanding financings. Alternately, the County can use the indicator rating to evaluate the impact of contemplated structural options on its cost of borrowing.

Together with responsible action on the part of the County, implementing these recommendations will assist in meeting the ultimate purpose of the DCR -- to give County decision makers the information they need to ensure the County has the capacity to borrow whenever necessary under the most favorable terms afforded by the market.